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No. 84-613

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1984

EMI LIMITED,

*Petitioner,*

v.

WILLIAM BENNETT, AND ERNEST J. DRONENBURG, JR., SUCCESSOR; KENNETH CORY; RICHARD SILBERMAN, AND MARY ANN GRAVES, SUCCESSOR; AND MARTIN HUFF AND GERALD H. GOLDBERG, SUCCESSOR,

*Respondents.*

**Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit**

## BRIEF OF ORGANIZATION FOR FAIR TAXATION OF INTERNATIONAL INVESTMENTS, INC. AS *AMICUS CURIAE* SUPPORTING CERTIORARI

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**Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit**

## BRIEF OF ORGANIZATION FOR FAIR TAXATION OF INTERNATIONAL INVESTMENTS, INC. AS *AMICUS CURIAE* SUPPORTING CERTIORARI[1]

### INTEREST OF *AMICUS CURIAE*

The Organization for Fair Taxation of International Investments, Inc. ("OFTII"), is a Delaware nonprofit corporation with membership comprised of domestic subsidiaries of foreign corporations that do not do business directly and do not maintain permanent establishments in

[1] Petitioner and respondent have filed letters with the Clerk of this Court consenting to the filing of this *amicus curiae* brief.

the United States. The purpose for which OFTII was organized is to represent its members' interests in matters of State taxation and to seek legislative and judicial solutions to problems of double taxation and tax burdens on foreign commerce. OFTII members include the corporations listed in Appendix 1, *infra*. These corporations are treated as unitary businesses with their foreign parents and have their foreign parents' foreign incomes included in the domestic corporations' apportionable California income tax bases.

The fundamentally important issue before the Court on this petition is whether a foreign parent whose foreign income is combined with that of its domestic subsidiary to create a base upon which a State apportions income tax has, itself, standing to challenge the constitutionality under the Foreign Commerce Clause of the inclusion of such foreign parent's income in the State's apportionment formula.

OFTII, on behalf of its members, has a direct interest in having this Court address the issue of the standing of a foreign parent with respect to foreign commerce because, in the event a foreign parent has no standing, the entire burden of demonstrating that the unitary tax unconstitutionally burdens foreign commerce will fall on the members of OFTII: domestic subsidiaries that conduct little or no business in foreign commerce and that have no direct knowledge as to the income of the foreign parent beyond what they themselves generate.

## SUMMARY OF ARGUMENT

Petitioner (EMI), a foreign corporation that does not do business in the United States, has alleged three grounds of injury: (1) Burden and expense of compliance; (2) risk of violating English law in making disclosure of

information required in computing California's worldwide income tax; and (3) loss in value of petitioner's investment in its United States subsidiary against which the worldwide assessment is exigible. OFTII, as *amicus*, takes no position with respect to the alleged violation of English law (British Official Secrets Act) or the merits of petitioner's case, but does urge this Court to direct the lower United States court to hear petitioner's claims on their merits and decide the constitutional issues that clearly exist should petitioner prove its allegations. The issue now before this Court is not whether petitioner's claims are true but whether, taking those claims as true, petitioner states a case arising under the Constitution of the United States and has standing to vindicate its claims in United States courts.

The foreign parent corporation of a domestic subsidiary should have standing to sue in the United States courts for injuries to its commerce caused by California's unitary tax scheme for the following reasons:

1. A foreign corporation that does not do business in the United States is denied entry to the courts of California to adjudicate its claims of injury to foreign commerce caused by California's tax scheme.

2. A foreign corporation's claim that, on its face, demonstrates injury to itself and to foreign commerce as a result of State action, presents a case arising under the Constitution of the United States that can be heard in United States courts.

3. Petitioner's claim, on its face, demonstrates burdens on itself and on the foreign commerce of the United States. The intervention of a foreign government in the case as *amicus* reinforces petitioner's claims of injury to the foreign relations of the United States.

4. This Court have already held that the State of California has no authority to impose burdens on the instrumentalities of the foreign commerce of the United States or to interfere with the Federal Government's "one voice" in foreign affairs. Petitioner should be permitted to offer its case to show violation by the State of this Court's prior decisions and the Constitution.

Petitioner's claims clearly state a case or controversy arising under the Constitution; petitioner, a foreign corporation, has no other plain, speedy and efficient remedy to adjudicate its claims; the case is ripe for adjudication since the tax has already been assessed by California and paid by petitioner's subsidiary; the conclusion is inescapable, therefore, that petitioner or any other foreign corporation similarly situated should have standing to sue for redress in the courts of the United States.

## ARGUMENT

### PETITIONER, A FOREIGN CORPORATION THAT DOES NOT DO BUSINESS IN THE UNITED STATES, ALLEGES AN INDEPENDENT INJURY TO ITSELF AND TO UNITED STATES FOREIGN COMMERCE BY REASON OF CALIFORNIA'S UNITARY TAX SCHEME. THIS STATES A CASE ARISING UNDER THE CONSTITUTION AND SHOULD CONFER STANDING TO SUE IN UNITED STATES COURTS.

#### A. Petitioner And Others Similarly Situated Suffer Independent Injuries To Themselves Under California's Unitary Tax Scheme.

Petitioner alleges an injury that, for the purposes of this petition, must be taken as demonstrated. The court below, nevertheless, dismissed petitioner's claims on the grounds that petitioner's injury was that of a shareholder and purely derivative. In the words of the Court of Appeals, "EMI's only possible injury is the diminution in

value of its holding in Capitol." Petitioner's Appendix A-6. If this view stands, there is no forum in which a claim of injury to foreign commerce can be adjudicated. A U.S. subsidiary assessed with a tax based on its foreign parent's foreign source income cannot allege a violation of the Foreign Commerce Clause in either State or Federal courts since the subsidiary is not in foreign commerce and, therefore, clearly has no standing to complain of a foreign commerce injury. If the foreign parent also has no standing, then the Foreign Commerce Clause is *terra infirma* for private parties. Petitioner does, indeed, allege a direct injury based not solely on its position as a shareholder and should be permitted to offer evidence to prove that allegation.

Petitioner has alleged that it is directly burdened by California's unitary method of taxation. Central to those burdens is the requirement that Petitioner supply detailed financial information concerning its worldwide operations. In *Alcan Aluminium* v. *Department of Rev. of State of Or.*, 724 F.2d 1294 (7th Cir. 1984), the court recognized the foreign parent's "independent injury" as a basis for standing. Key among those injuries is the obligation to supply detailed financial information. *Id.* at 1296. Petitioner (EMI) here has made the same allegation: that *it* is forced to produce detailed financial information concerning its worldwide activities.

States utilizing unitary taxation engage in the ploy of directing requests for information to the domestic subsidiary. Those requests, however, involve detailed inquiries with respect to the operations of the foreign parent and its foreign subsidiaries. Subsidiaries do not in the normal course collect detailed financial information on their parents and their parents' foreign holdings. Subsidiaries simply cannot respond to such demands and, if

the requests are to be honored, they are a burden which falls squarely on the foreign parent.

More often than not, even the foreign parent cannot honor the requests because the requests presume that the rest of the world operates according to the State's tax accounting principles. This presumption is palpably untrue. Were unitary tax apportionment to be universally adopted, it would also require uniform standards of tax accounting be adopted. If the latter is not done, multinationals would be required to maintain as many separate and parallel accounting systems for *each unitary nation* in which they operate as there are unitary nations *in total*. No company could afford such accounting systems.

The Seventh Circuit Court of Appeals, in a factually similar case, *Alcan Aluminium, supra.*, reached the opposite conclusion from the court below (Ninth Circuit) on the issue of standing of the foreign parent. In the words of the [Seventh Circuit] Court of Appeals:

> Appellant [Alcan] has alleged an independent injury as basis for standing. It claims an unconstitutional burden on its foreign commerce. If appellant's allegations are accepted as true, its interests and those of . . . [Alcan's U.S. subsidiary] are not identical [citation omitted]. Thus . . . [the U.S. subsidiary's] state remedy does not protect appellant fully. As soon as the tax is assessed against . . . [the U.S. subsidiary] the threat of injury to appellant will be immediate.
>
> [724 F.2d at 1299]

The court's ultimate dismissal of the case was based, not on lack of standing, but on ripeness—Oregon refused to issue a final assessment of the tax while the case was pending. The tax will, apparently, never be assessed since Oregon has now repealed its unitary tax statute. There is no issue of ripeness in the instant (EMI) case.

Petitioner should, therefore, have standing to sue in United States courts under the standard announced by the Seventh Circuit Court of Appeals.

It is not an answer to say that the imposition of a tax on a domestic subsidiary of a foreign parent is a matter affecting only the subsidiary directly. Under California law, the worldwide combined unitary group is defined as "the taxpayer," but only the domestic unit of that group is allowed access to the State's courts, and then only as to matters affecting the computation of the tax. CALIFORNIA REV. & TAX CODE, § 25101 provides:

> When the income of a taxpayer subject to the tax imposed under this part is derived from or attributable to sources both within and without the state, the tax shall be measured by the net income derived from or attributable to sources within the state in accordance with the provision of Article 2 . . . [the three factor apportionment provisions].

As applied by California, this provision includes the foreign parent since its income becomes the base upon which the worldwide combined income tax is apportioned. For purposes of legal action, however, the "taxpayer" is apparently limited to the entity that actually pays the tax, i.e., the domestic subsidiary. The parent cannot "pay" the tax since it neither does business nor files tax returns in California. There is, therefore, no forum provided by California in which petitioner or any other foreign parent can raise the claims petitioner seeks to adjudicate in Federal court. *Capitol Industries-EMI, Inc.* v. *Bennett*, 681 F.2d 1107, 1118-1119 (9th Cir. 1982), *cert. denied*, 459 U.S. 1087, (1982); *cf.*, Petitioner's App. A-4 (9th Cir. Opinion). The State courts are not, in any event, appropriate fora in which a claim of injury to the foreign commerce of the United States or a violation of the Foreign Commerce Clause should be adjudged. In the State court

opinion reversed by this Court in *Japan Line, Ltd.* v. *County of Los Angeles*, 441 U.S. 434 (1979), the philosophy expressed by the California Supreme Court made it clear why a state court should not be allowed to decide a Foreign Commerce Clause case:

> [T]he threat of double taxation from foreign taxing authorities has no role in commerce clause considerations of multiple burdens, since burdens in international commerce are not attributable to discrimination by the taxing state and are matters for international agreement.
>
> [441 U.S. at 439, quoting Cal. Sup. Court]

**B. Petitioner's Claims State A Case Or Controversy Arising Under The United States Constitution That Should Confer Standing To Sue In United States Courts.**

In *Container Corp.* v. *Franchise Tax Board*, 463 U.S. 159, 77 L.Ed.2d 545 (1983), this Court expressly declined (n.26) to address the question whether California's unitary income tax scheme, when applied to a foreign parent corporation of a domestic subsidiary, violated the Foreign Commerce Clause of the Constitution. This Court went further (n.32) and recognized that there might be more foreign policy significance to the incidence of a tax that falls on a foreign interest than one that falls on a domestic interest. The petitioner now presents the exact question left open by this Court in *Container*. This case, based on the allegations of petitioner, properly falls within the rubric of *Japan Line, supra*. The two principal distinctions that indicated a result in *Container* (enumerated by this Court, 77 L.Ed 2d at 567-568) opposite from *Japan Line*, do *not* exist in this (EMI's) case:

1. The division of the tax base "pie" between formulary apportionment and "arm's length" allocation may result in a fairly apportioned or even a lower tax in the case

of a domestic parent, *e.g.*, *Chicago Bridge & Iron Co.* v. *Caterpillar Tractor Co., Illinois Dept. of Rev. et al.*, ___ U.S. ___, No. 81-349 (1983, dismissed) depending upon the facts of the case. Thus, double taxation may not actually occur. In the case of a foreign parent with substantial foreign (to the U.S.) source income and a domestic (U.S.) subsidiary with relatively smaller U.S. source income, California's formulary apportionment will generally increase greatly the amount of California's assessment for which no relief at all can be obtained in the foreign parent's domiciliary jurisdiction or any other foreign jurisdiction.[2]

2. The incidence of California's tax based on petitioner's foreign source income falls, contrary to the facts in *Container*, on the foreign owners of an instrumentality of foreign commerce. For example, a foreign parent corporation with income twelve times greater than its domestic (U.S.) subsidiary (a ratio achieved or exceeded by several OFTII members) may have a California formulary income *tax* assessed against the domestic subsidiary that exceeds the taxable *income* of the subsidiary. Any contribution toward payment of the California tax by the foreign parent would be a nondeductible capital contribution to the domestic subsidiary. Hence, the income tax that is levied by California on income that is also taxed by the foreign domiciliary jurisdiction cannot even be apportioned ratably among the multinational group members by a tax-sharing agreement such as is commonly

---

[2] Several OFTII members have experienced decreases in apportioned taxes due to inclusion of foreign parents' losses in the tax base. They, nevertheless, oppose the unitary method because the compliance burden is out of all proportion to any possible benefit and because a decrease is an aberrant in the normal result.

used by domestic corporate groups filing consolidated returns. Double taxation is almost inevitable.

There are other factors present in California's unitary income taxation scheme that clearly demonstrate the burden on foreign commerce when the scheme is applied to include a foreign parent corporation. These are:

(a) In order to compute the correct apportionment of California tax, the foreign parent must conform its accounting practices to California tax accounting principles. This may be very difficult to accomplish and, given the wide divergence in accounting principles between foreign countries and the U.S., very expensive as well.

(b) The necessity to convert foreign currency transactions to U.S. dollars for California tax purposes is an additional and direct burden on a foreign parent. A domestic corporation with foreign subsidiaries must calculate currency conversions to U.S. dollars for many purposes, including financial disclosure and State and Federal tax returns. A foreign based multinational must calculate currency conversions for its domiciliary jurisdiction and, under California's rules, also prepare conversions to U.S. dollars. This is a direct and burdensome chore imposed by California on the foreign parent.

(c) The "more searching inquiry" addressed to tax apportionment in foreign commerce by *Container* (77 L.Ed.2d at 555) mandates an opposite result from *Container* in the case of a foreign parent. The theory of California's unitary taxation scheme upheld by *Container* is that services, know-how, and guidance are provided by a parent to its subsidiaries. *Cf.*, *Chicago Bridge & Iron Co.*, *supra*. These services, it was found by the California courts, create income that would escape taxation domestically, except, perhaps indirectly, through inclusion of foreign source dividends in the domestic tax

base. *Cf.*, *Mobil Oil Corp.* v. *Commissioner*, 445 U.S. 425 (1980). This principle cannot, on its face, apply to a foreign parent of a domestic subsidiary. Any benefit the subsidiary dervies from management expertise and services provided by a foreign parent *increases* domestic income subject to tax. The jurisdiction that may suffer loss of tax revenue under such circumstances is the foreign jurisdiction in which the *parent* providing services is domiciled. Prevention of shifting of income, deductions and credits among members of a controlled group is, to be sure, the function of INTERNAL REVENUE CODE, § 482 embodying the "arm's length" trading standard adopted by the United States and virtually every one of its international trading partners. The "arm's length" standard is, of course, rejected by California's "unitary" tax scheme.

The application of unitary apportionment "upstream" (from subsidiary to foreign parent) violates the basic principles upon which the unitary income tax scheme rests, namely, "downstream" apportionment to include in the tax base foreign source income produced as the result of domestic expenditures and activities. "Downstream" apportionment, *i.e.*, including the subsidiaries of a parent corporation that controls and directs the activities of those subsidiaries, has a much less chilling effect on foreign commerce and foreign relations where the parent is domiciled or does business in the taxing jurisdiction. A downstream apportionment theory is applied by INTERNAL REVENUE CODE, § 861 and the regulations thereunder, but limited to United States domiciliary parents of foreign corporations. The power of the States to apply a somewhat similar "downstream" apportionment for *domestic parent* taxpayers was upheld in *Container*. The basic premise of that application is missing entirely in the case of the *foreign parent* of a *domestic* subsidiary. "Up-

stream" apportionment, *i.e.*, including foreign income of a foreign parent based on the domestic subsidiary's activities, not only rests on questionable economic principles, but has a direct and chilling effect on foreign commerce and the foreign relations of the United States. This is made clear in the *amicus* brief filed by Her Britannic Majesty's Government in support of the petitioner in this case. The difficulties of trying to negotiate a tax treaty with the United States where the Federal Government does *not* speak for the States are amply illustrated by the history of the 1975 U.S.-U.K. Tax Convention and the current suspension of negotiations with the German Federal Republic (West) and the Netherlands.

**C. This Court Already Held That State Taxation Of Instrumentalities Of Foreign Commerce Creates Impermissible Burdens And Interferes With Federal Constitutional Powers. Those Decisions At Least Confer Standing Upon Petitioner To Sue In United States Courts To Vindicate Its Constitutional Claims.**

Petitioner, a foreign corporation that does not do business in the United States, alleges that inclusion of *its* (wholly foreign source) income in California's pre-apportionment tax base has resulted in an unconstitutional burden on foreign commerce. *Japan Line, supra.*, stands as this Court's most recent statement of constitutional standards by which burdens on foreign commerce are to be measured. Although this Court reached the issue of the burden on foreign commerce in their recent decision in *Container, supra.*, it is clear that they limited application of *Container* to the situation of a *domestic* parent:

> We have no need to address in this opinion the constitutionality of combined apportionment with respect to state taxation of domestic corporations with foreign parents or foreign corporations with either foreign parents or foreign subsidiaries.
>
> [*Id.* at 568, n. 26]

This Court further pointed out the analogy articulated in *Japan Line:*

> We specifically left open in Japan Line the application of that case to "domestically owned instrumentalities engaged in foreign commerce," . . . [citation omitted] and—to the extent that corporations can be analogized to cargo containers in the first place—this case falls clearly within that reservation.
>
> [*Id.* at 568]

By means of the same analogy, it is clear that a foreign parent is the equivalent of foreign "owned instrumentalities engaged in foreign commerce" and falls squarely within the doctrine articulated in *Japan Line, supra.*

**D. Proof Of Impermissible Burden On Foreign Commerce Forbidden In *Japan Line* Is Most Appropriately Presented By Foreign Parents.**

In *Japan Line* this Court encountered a similar method of local taxation and held that it placed impermissible burdens on foreign commerce. *Japan Line* involved an action by six Japanese shipping companies incorporated under the laws of Japan and that had their principal places of business and commercial domiciles in that country. Plaintiffs in *Japan Line* challenged the constitutionality of the imposition of California's *ad valorem* property tax to shipping containers owned by the plaintiffs, used exclusively for transportation of cargo in foreign commerce, and subject to property tax in Japan. California imposed the *ad valorem* property tax on plaintiffs' containers which "passed through" the State during the course of their international journeys.

In *Japan Line,* this Court found that California's *ad valorem* property tax, as applied to the foreign plaintiffs'

shipping containers, which were temporarily located in California, but which were also based, registered and subjected to property tax in Japan, was unconstitutional because it resulted in multiple taxation of the instrumentalities of foreign commerce. This Court noted that when a State seeks to tax foreign instrumentalities, the principles of the Foreign Commerce Clause bring two distinct considerations into play. The first is the enhanced risk of multiple taxation. This Court observed:

> Due to the absence of an authoritative tribunal capable of ensuring that the aggregation of taxes is computed on no more than one full value, a state tax, even though "fairly apportioned" to reflect an instrumentality's presence within the State may subject " 'foreign commerce to the risk of a double tax burden to which [domestic] commerce is not exposed, and which the commerce clause forbids.' "
>
> [*Id.* at 447-448]

The second consideration identified by this Court is the fact that "a state tax on instrumentalities of foreign commerce may impair federal uniformity in an area where federal uniformity is essential." *Id.* at 448. This Court unequivocally declared that "foreign commerce is preeminently a matter of national concern." *Ibid.* This Court identified two critical ways in which a State tax on instrumentalities of foreign commerce may frustrate the achievement of federal uniformity:

> [1] If the State imposes an apportioned tax, international disputes over reconciling apportionment formulae may arise.
>
> [2] If a novel state tax creates an asymmetry in the international tax structure, foreign nations disadvantaged by the levy may retaliate against American-owned instrumentalities present in their jurisdictions. Such retaliation of necessity would be

> directed at American transportation equipment in general, not just that of the taxing State, so that the Nation as a whole would suffer. If other States followed the taxing State's example, various instrumentalities of commerce could be subjected to varying degrees of multiple taxation, a result that would plainly prevent this Nation from "speaking with one voice" in regulating foreign commerce.
>
> [*Id.* at 450-451]

It is these principles, identified by this Court in *Japan Line*, that directly control petitioner's cause.

Domestic subsidiaries are not equipped to present to a court the type of evidence necessary to demonstrate whether double taxation has been avoided and federal uniformity achieved, as required by *Japan Line:*

1. ***Double Taxation.***

In the context of a foreign parent-domestic subsidiary combination, the risk of double taxation occurs when the income of the foreign parent or one of its foreign subsidiaries is included in the unitary tax base. If this income has been taxed as though wholly attributable to the host country of the foreign parent or its foreign subsidiary, then the use of it again to assess California's tax results not simply in the *risk* of double taxation, but in double taxation in fact.

It is clearly the foreign parent, not its domestic subsidiary, that sees and pays this double tax. It is the foreign parent that has the knowledge of how it and its foreign subsidiaries are taxed by their host countries. It is the foreign parent whose income is reduced by multiple taxes on the same income. To suggest that a domestic subsidiary does or should have information concerning

these double taxes simply ignores the reality of corporate organization.

2. ***Federal Uniformity.***

It is quite unreasonable to require a domestic subsidiary to become involved directly in international disputes over reconciliation of apportionment. It is the foreign parent that must negotiate competing claims to tax income from its worldwide operations, and it will be the foreign parent, *not* the domestic subsidiary, that controls the worldwide investment decisions based on different taxing schemes. It is also the foreign parents that monitor the world's financial and tax structures in order to make sound investment decisions. Many members of OFTII do not do business outside the United States at all and, therefore, are totally indifferent in their normal course of operations to any asymmetry in the international tax structure which could result in retaliation. To assert it must be the domestic subsidiary that bears the burden of proof in a foreign commerce case ignores the realities of both the burden and of normal corporate organization.

## CONCLUSION

For the reasons stated, the petition should be granted and the case remanded to be heard on the merits of

petitioner's claims of injury under the Foreign Commerce Clause.

Respectfully submitted,

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# APPENDIX

# APPENDIX 1

The Organization for Fair Taxation of International Investments, Inc. ("OFTII"), a Delaware nonprofit corporation, includes the following corporations organized and doing business in the United States:

Alcan Aluminum Corporation
Allied-Lyons North America Corp.
BASF America Corp.
BATUS, Inc.
Beecham, Inc.
The BOC Group
Elf Aquitaine, Inc.
Foseco Minsep
Gold Fields American Corp.
Harrison & Crosfield (America) Inc.
ICI Americas Inc.
INCO United States, Inc.
Lever Brothers Company
Moet-Hennessy U.S. Corp.
Nestle Enterprises, Inc.
Shell Oil Company
Siemens Capital Corporation
Silor Optical, Inc.
Sony Corporation of America
Thorn EMI (USA) Inc.
Volkswagen of America, Inc.
Whatman, Inc.
and others